

US Pension Reform

Lessons from Other Countries

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Project Scope and Methodological Considerations



Book's Geographic Focus Is On;

- **Countries relatively similar to the US, i.e. “like units”**
 - OECD countries
 - Countries with ageing populations
 - Countries facing the related fiscal solvency challenges

Book's Methodology;

- Historical comparative (what has worked elsewhere?)
- Cannot yield detailed (model-based) reform proposals for US, but give the broad directions of a successful reform
- Attempt to avoid looking at “SS reform in a silo”, but include the effects of the broader US retirement income system (taxation, tax-breaks, corporate & state and local pensions are important)

Social Security In Broad International Comparison



SS has a fundamentally a sound design;

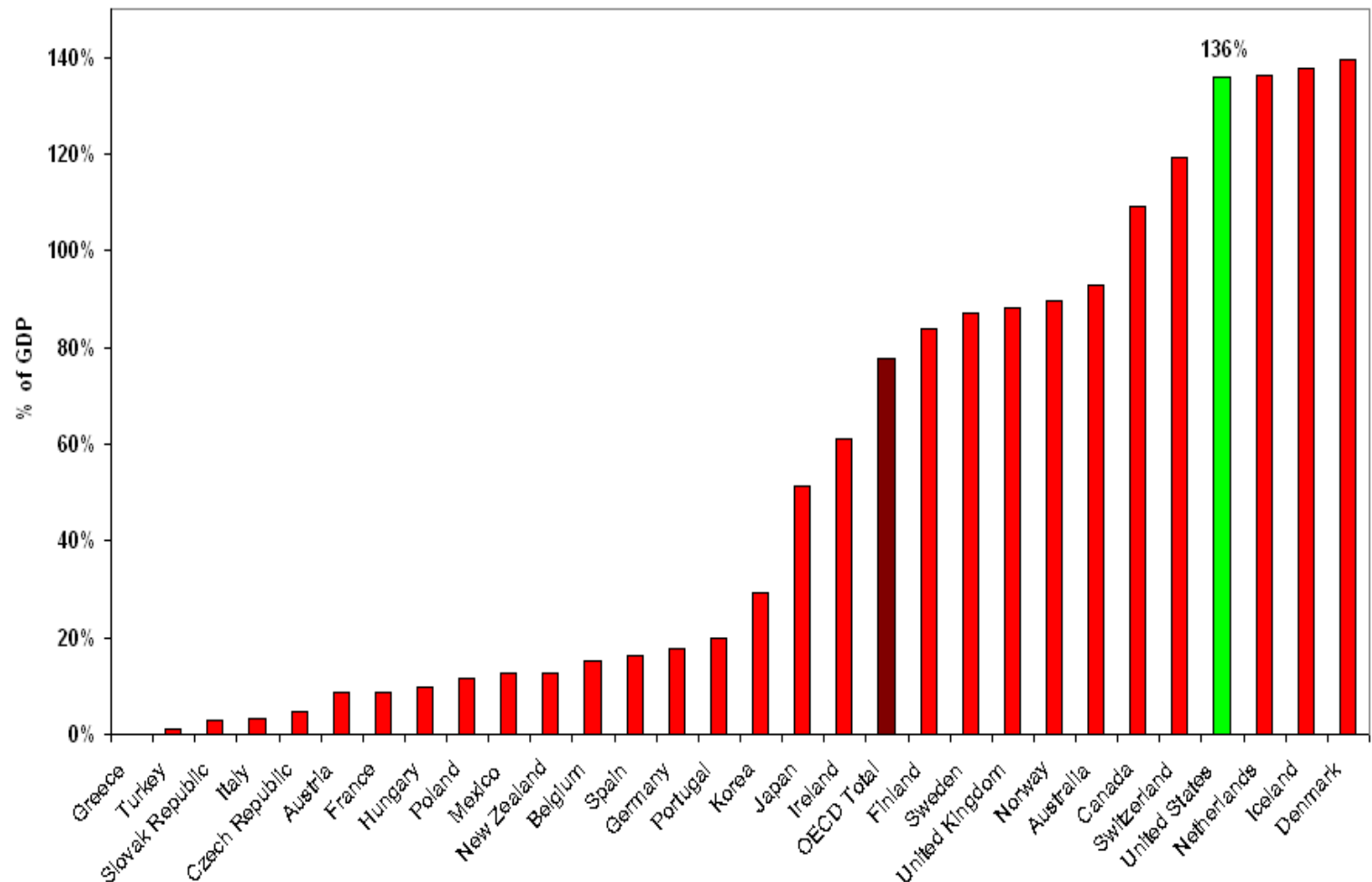
- **SS has a relatively modest in scope**
- **SS does not encourage (too) early retirement**
- **Relatively modest direct redistribution in SS benefit formula, especially compared to other English-speaking nations**
- **1983 SS reform occurred earlier than in other OECD countries and kept retirement eligibility ages relatively high**
- **SS funding shortfall relatively modest compared to both other OECD countries and healthcare in the US**
- **Projected SS Trust Fund exhaustion (2041) does not entail “complete collapse”, but does create huge political/legal problems, an enormous old-age poverty problem and an intergenerational distributional problem**

The Role and Level of Taxation and Private Pension Savings



- US has a very high level of pre-funded assets towards pension provision
- Principal issue less the quantity of savings, but rather their distribution and tax promotion

Total Pre-funded Assets Towards Pension Provision, 2006

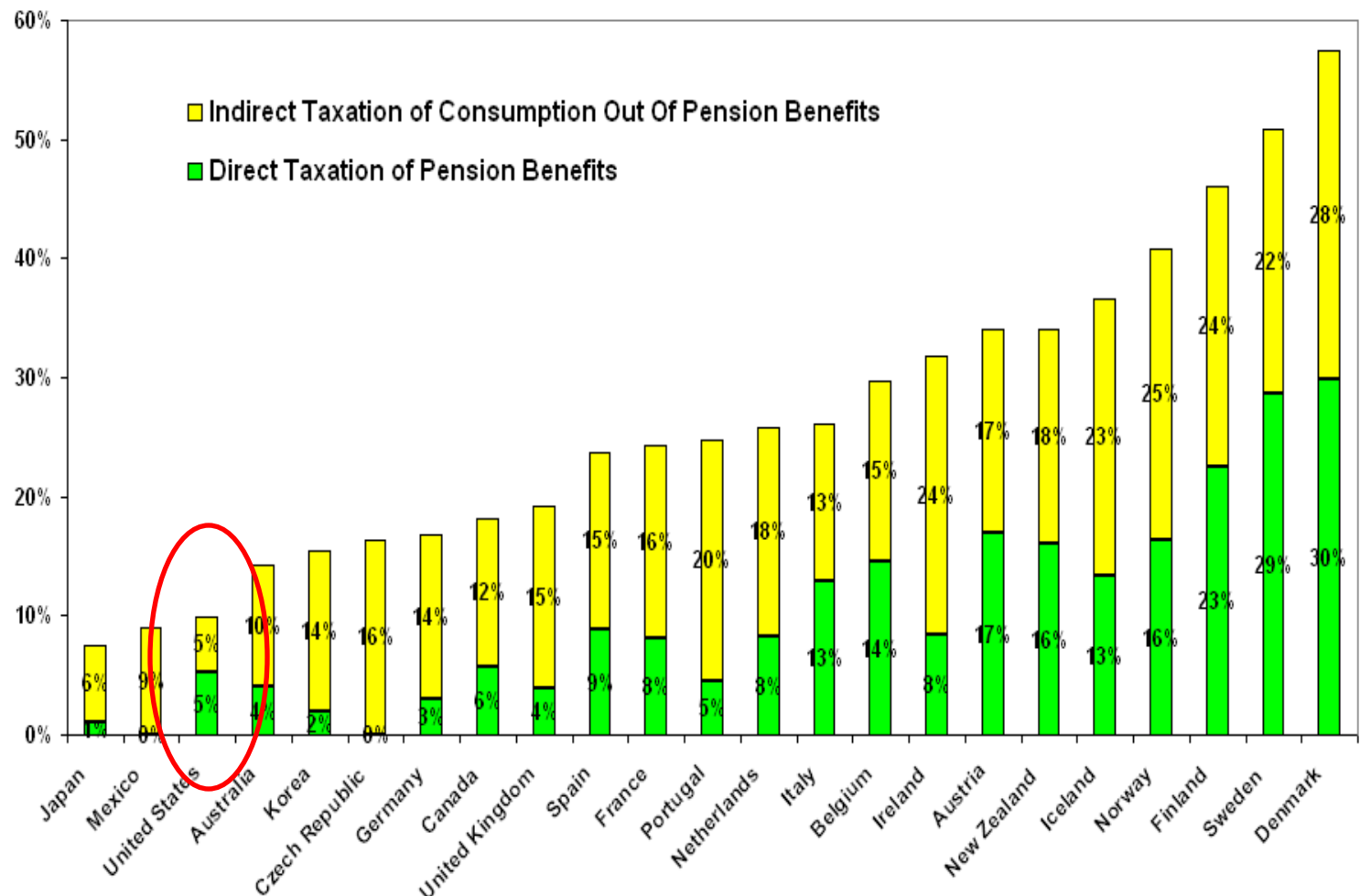


Source: OECD Global Pension Statistics, IMF, Authors

The Role and Level of Taxation and Private Pension Savings

- US has a low direct/indirect taxation of pension benefits
- The net after-tax costs of public pension benefit provision lower in other OECD countries

Total Taxation of Pension Benefits, 2003

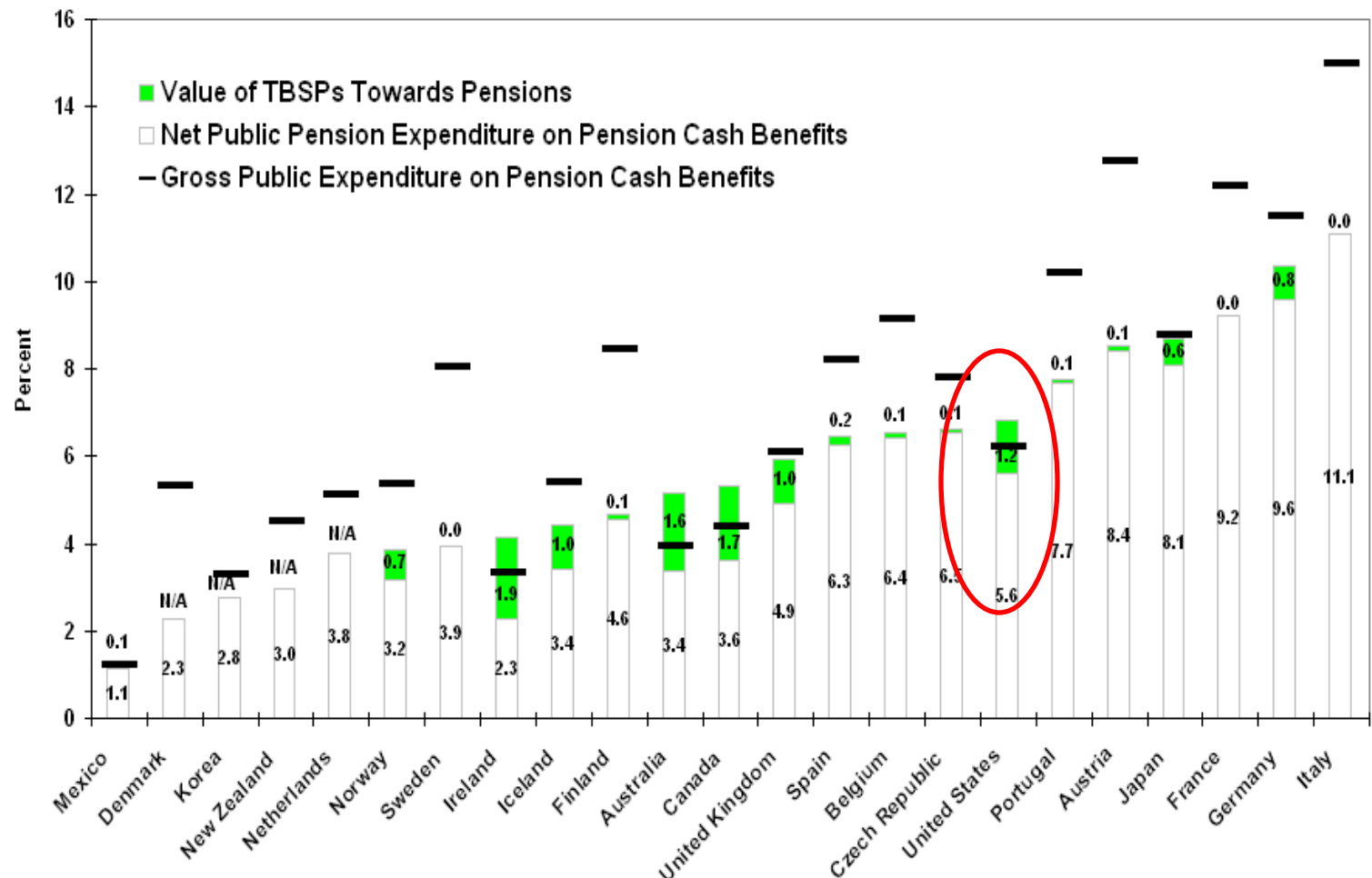


Source: OECD (2007; table 5.2 and appendix 2); authors' calculations

The Role and Level of Taxation and Private Pension Savings

- US spends more on tax-breaks to pensions than most other countries
- Total costs of public pension provision in the US higher than what gross expenditures indicates

Actual Cost of Public Expenditures On Pension Cash Benefits, 2003 % of Nominal GDP



TBSP = Tax Breaks for Social Purposes. Source: Authors' Calculations, based on OECD SOCX data

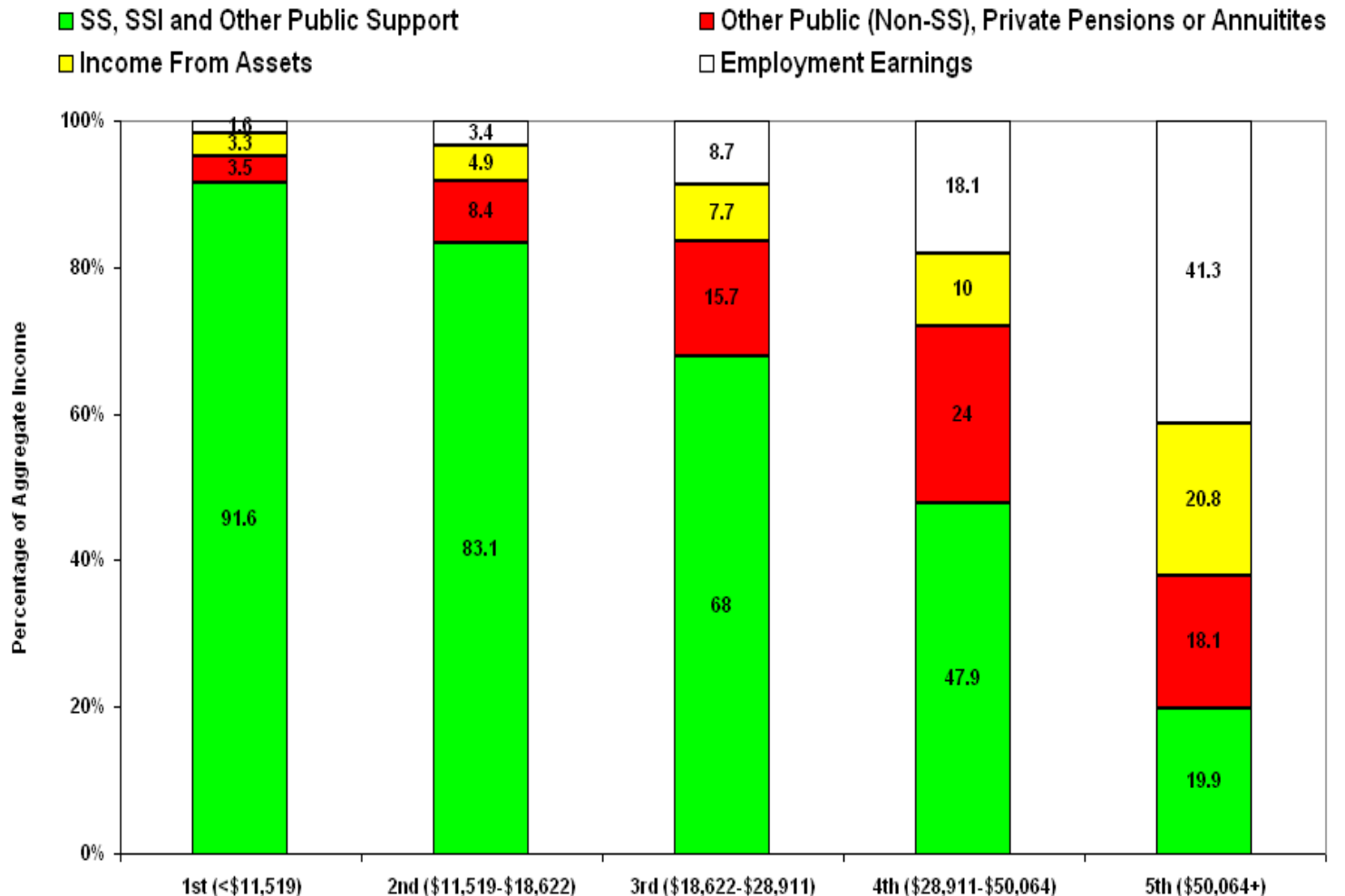
The Sources of Old-Age Income

- For the majority of retired Americans, **Social Security** is THE source of income

- Most Americans don't benefit from tax-breaks

- Only "high-incomes" eligible for SS benefit reductions

Sources of Aggregate Income, 2006 All Units Age 65+

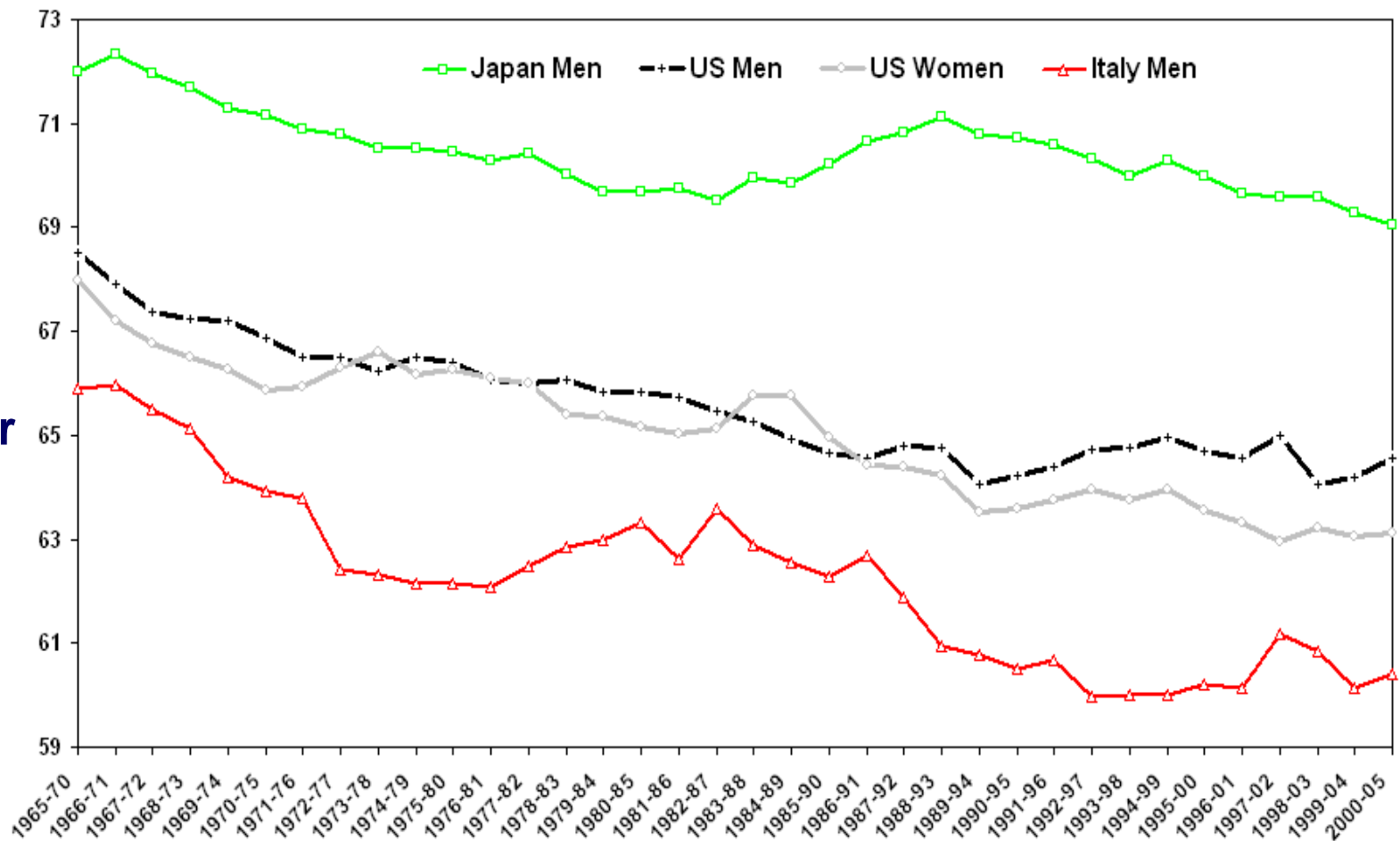


Source: *Income of the Population 55 or Older, 2006, table 10.5*. SSA February 2009

The Labor Market and Retirement Ages

- Effective retirement ages are down also in the US, but stable recently
- US in much better position than European countries, but worse off than Japan and Korea

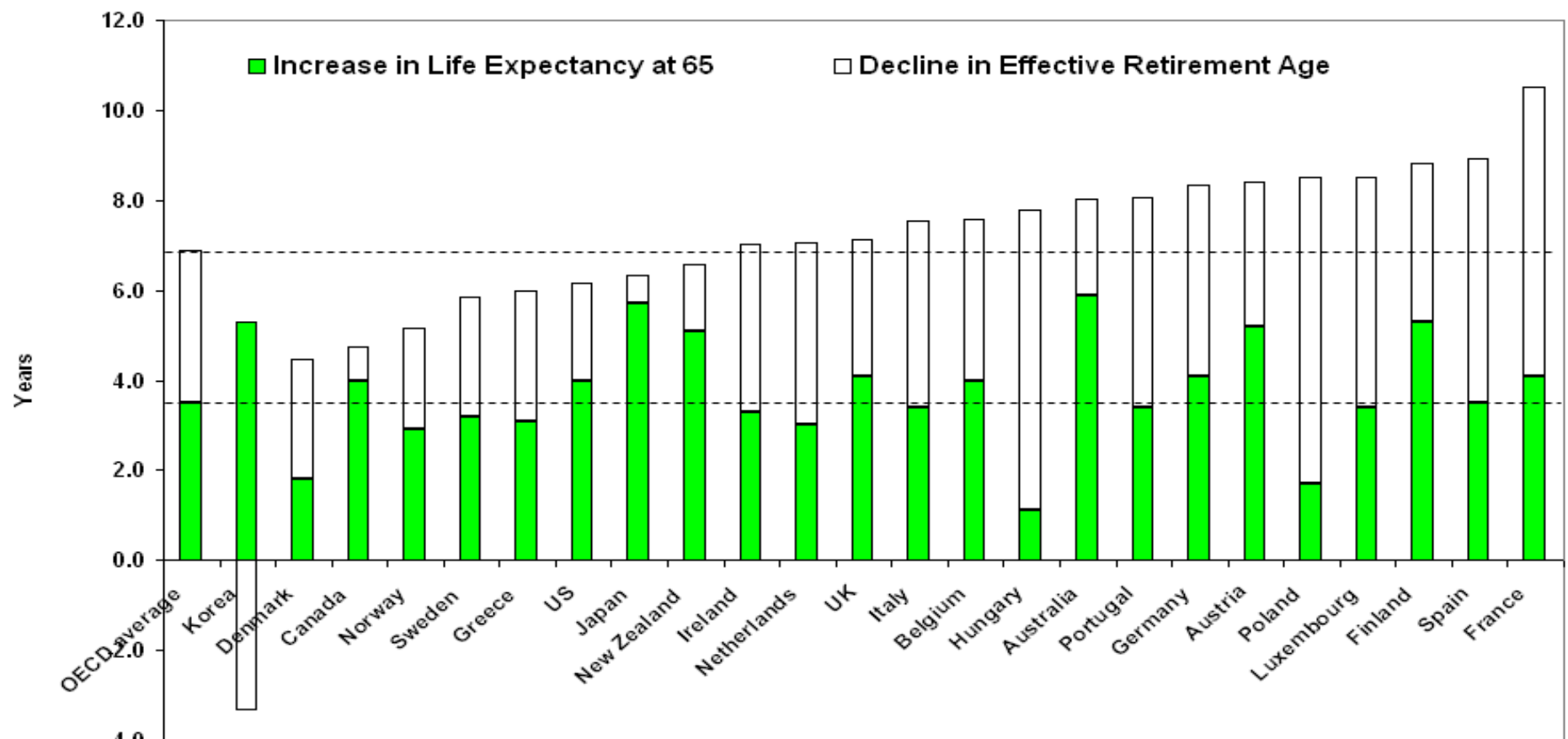
Average Effective Retirement Age 1970-2005



Notes: The average effective age of retirement is calculated as a weighted average of (net) withdrawals from the labour market at different ages over a 5-year period for workers initially aged 40 and over. Source: OECD

The Increase In “Time in Retirement” Has Been Large

The Components of Increase in Years in Retirement from 1970-2004, Men

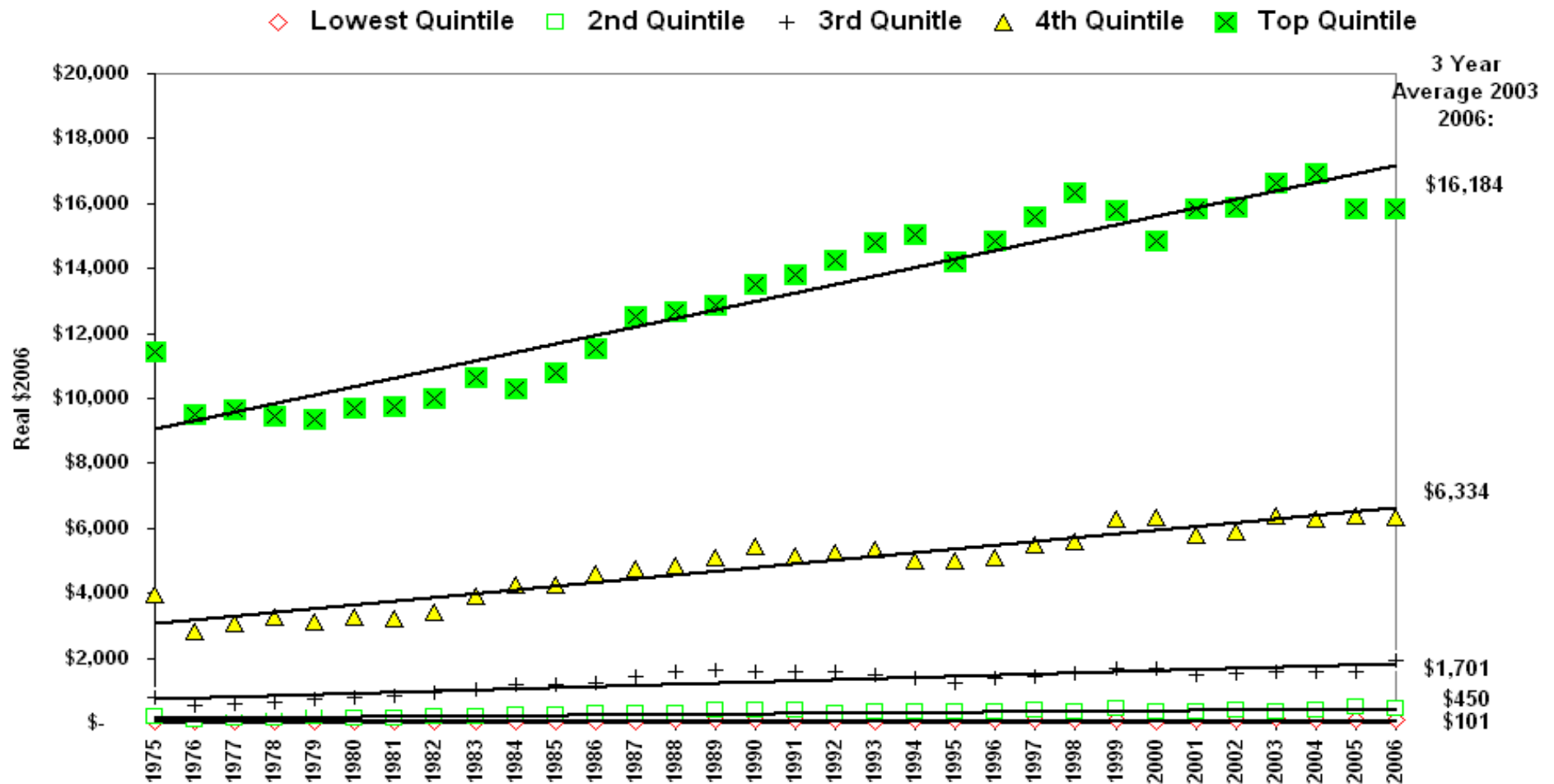


Source: OECD (2006d) and OECD Health Data 2007

Primer: Corporate and State/Local Government Pension Plans Is Not An “Old-age Poverty Issue”



Annual Real Income of Individuals Age 65 or Above From Any Private (Non-SS) Pension, by Income Quintile, Real \$2006



Source: EBRI Databook, chapter 7.

The Economic Crisis: A Focus on Corporate and State/Local Government Pension Plans



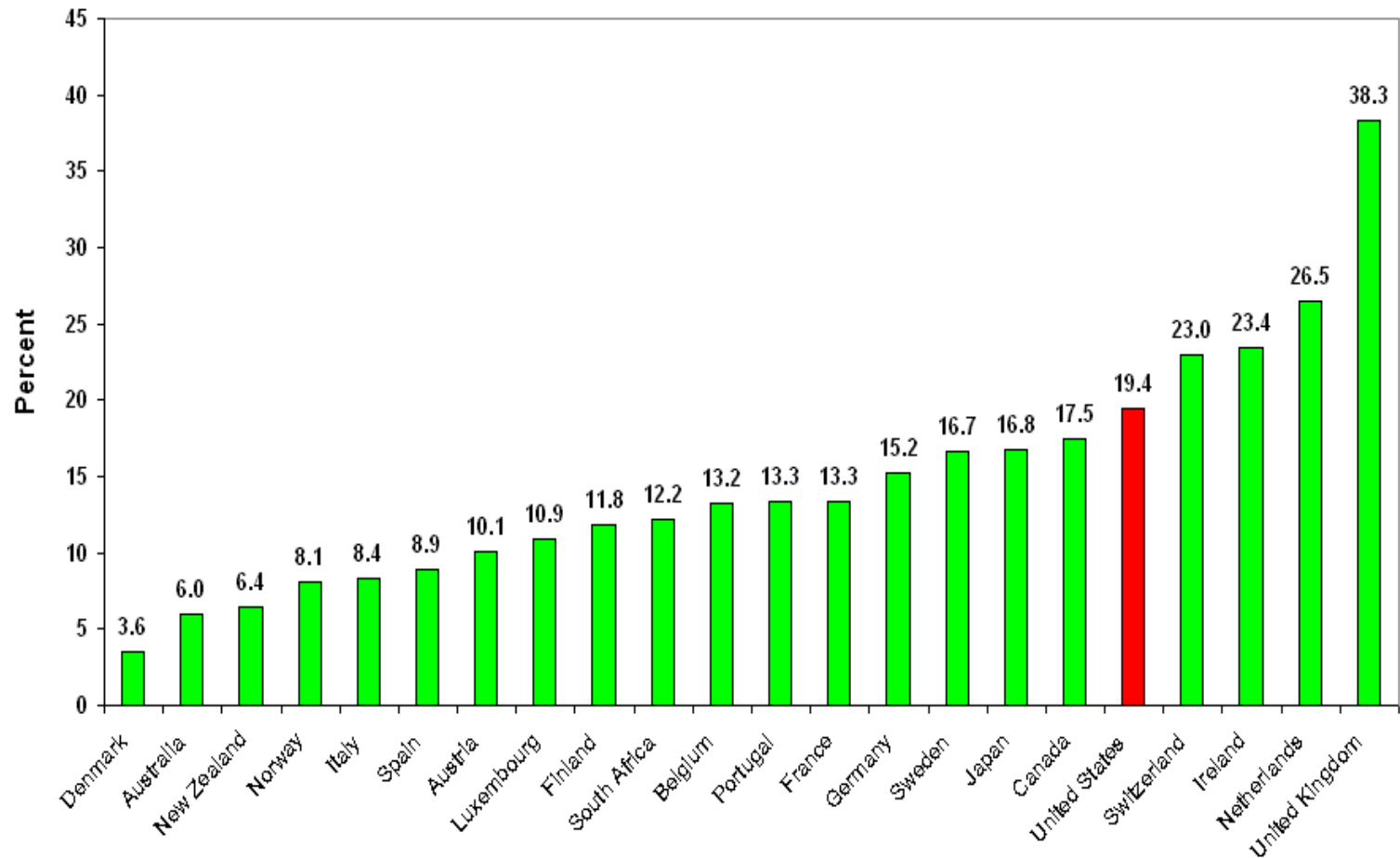
- **Impact of the crisis since mid-2008 very large – preliminary estimates indicate aggregate US pension fund losses of \$1tr/10% (CBO October 2008) or \$2.2tr/25% (OECD December 2008)**
- **Book written pre-crisis, but events have re-emphasized our conclusions;**
 - **Strengthens our case for not radically changing SS**
 - **Corporate pensions plans entered crisis at full funding, so will be in not “too bad” a shape (helped by AA-bond rates and PPTC Act of Dec. 2008)**
 - **State/Local pensions plans entered crisis on average ~20% underfunded, indicating acute funding pressures in some places**

Corporate Pension Liabilities Is Not A Competitive Disadvantage for US Companies



- Corporate DB pension obligations equally large (or larger) among US competitors
- Only US corporations' healthcare obligations constitute a (severe) competitive disadvantage in global markets

Value of Total Corporate DB Pension Obligation, Share of Companies' Market Capitalization, 2007



Source: Thomson Financial and OECD

Corporate Pension Plans More Volatile Than Elsewhere

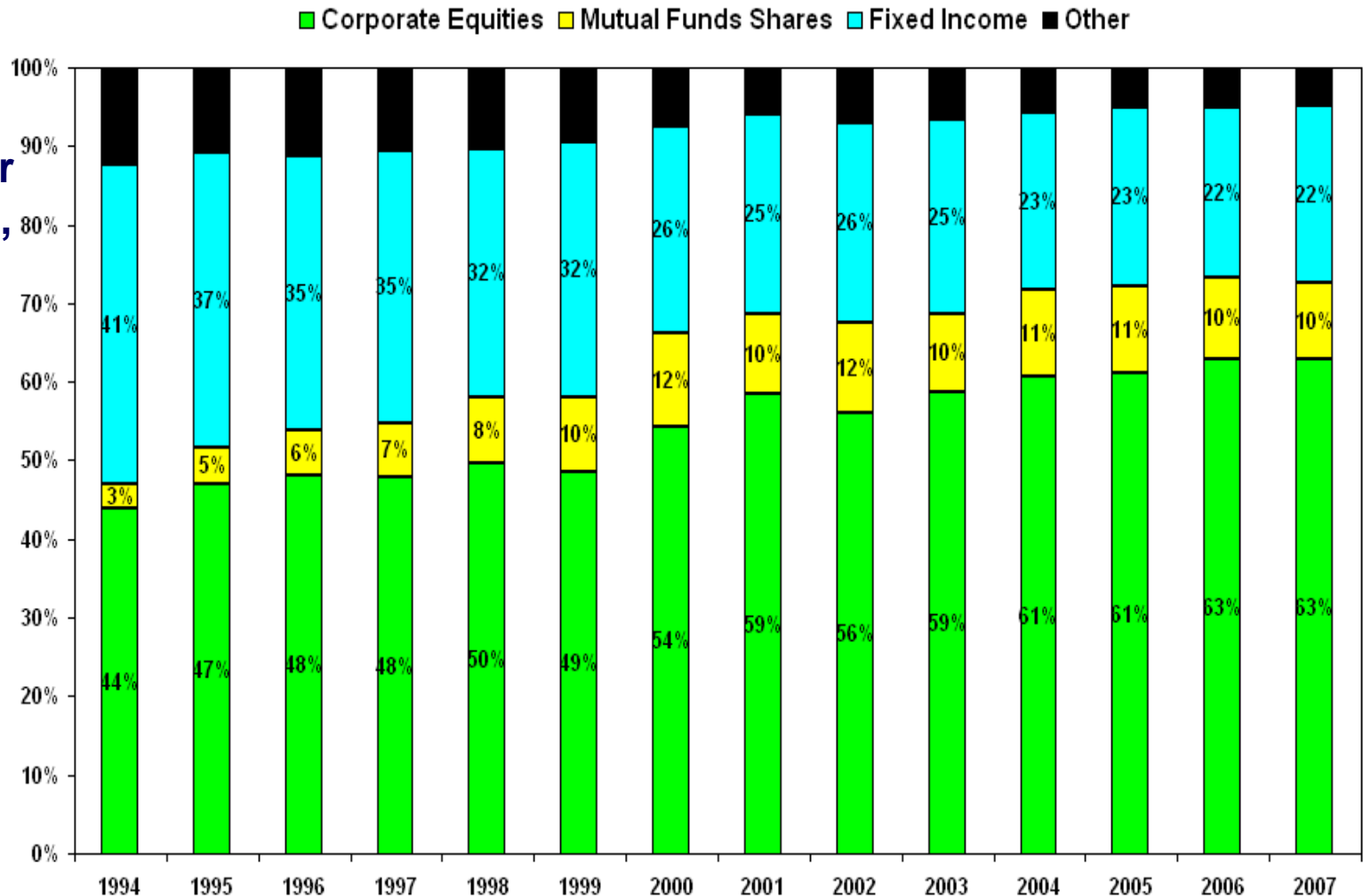


- US funds 2nd biggest loser in the OECD in 2008

- Profit-center in good times, and then it is “current jobs vs. retirees” in bear markets?

(Pension Protection Technical Correction Act of December 2008 = easing DB funding requirements)

Asset Allocation of US Private DB Plans 1994-2007



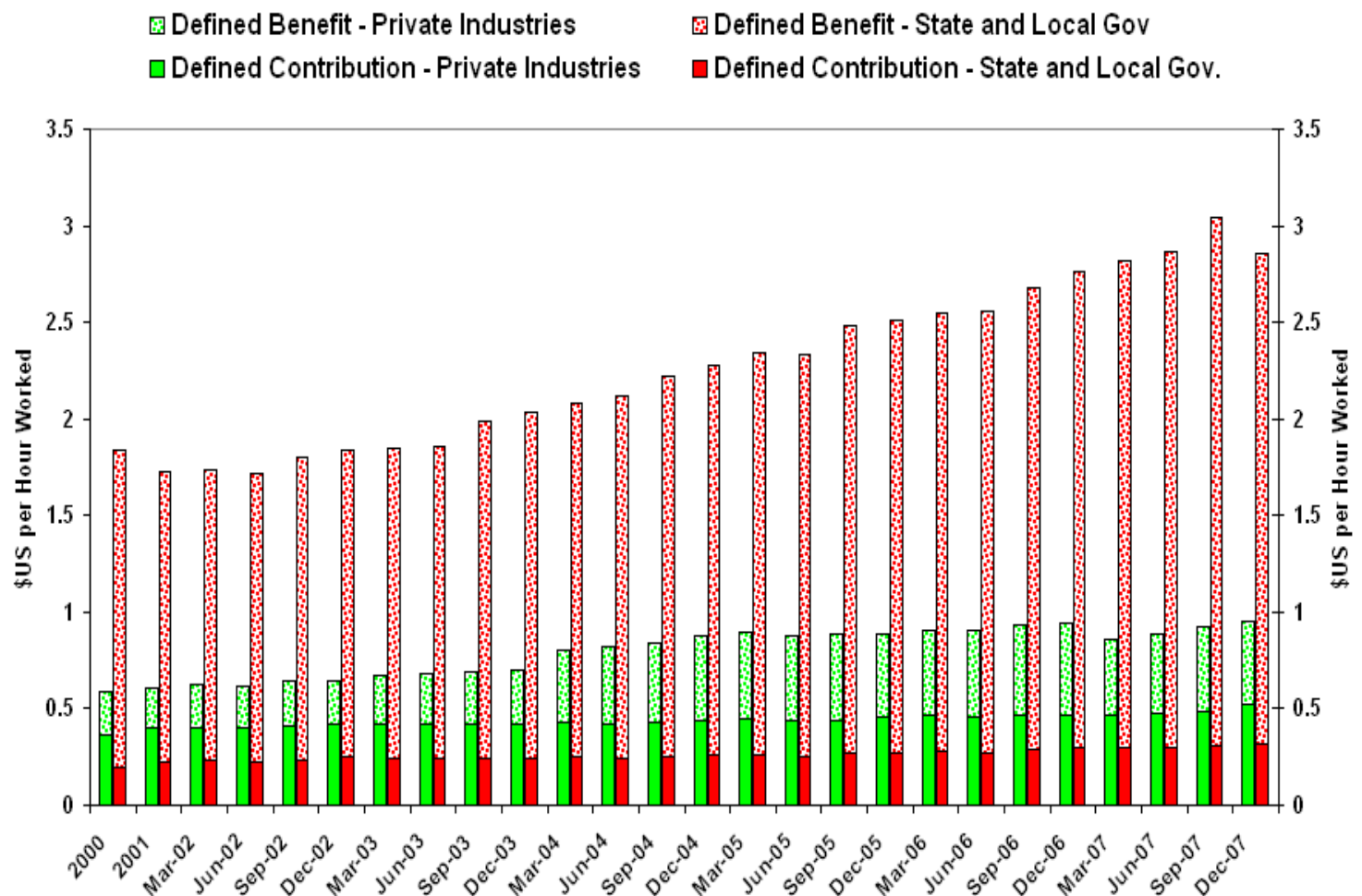
Note: "Fixed Income" includes short-term and credit market assets. "Other" equals Miscellaneous Assets in Flow of Funds accounts. Source: FRB (2008).

State and Local Government Pension Plans



- Very limited cost controls and shift from DB to DC plans in state/local government
- Much older workforce than private industry
- GASB 45 accounting standards moving gradually towards increased transparency (i.e. private sector accounting rules)

Employer Cost of Benefits per Hour Worked, All Employees in Sector



Note: SIC based data until 2003. NAICS based data 2004 onwards. Source: BLS ECEC Survey at <http://www.bls.gov/ncs/ect/home.htm>

State and Local Government Pension Plans



- Many state/local governments will struggle with the costs of their pensions in coming years
- Even with rapid market rebound, not enough to make up losses + increased costs
- Other countries show that the politics of “unequal pensions” ends with public worker pensions being cut down to the country’s average

Public Pensions Plans with <75% or Lower Funding end-2006			
	State	Fund Name	Fund Funding Ratio 2006
	Colorado	Colorado Public Employees Retirement Association	73.3%
	Connecticut	Connecticut State Employees Retirement System	53.2%
	Connecticut	Connecticut Teachers Retirement Board	68.4%
	Hawaii	Hawaii Employees Retirement System	65.0%
	Illinois	Illinois State Employees Retirement System	52.2%
	Illinois	Illinois Teachers Retirement System	62.0%
	Indiana	Indiana State Teachers Retirement Fund	43.4%
	Kansas	Kansas Public Employees Retirement System	68.8%
	Kentucky	Kentucky Retirement Systems	61.3%
	Kentucky	Kentucky Teachers Retirement System	73.1%
	Louisiana	Louisiana State Employees Retirement System	63.9%
	Louisiana	Louisiana Teachers Retirement System	67.5%
	Massachusetts	Massachusetts Teachers Retirement Board	67.2%
	Minnesota	Minnesota Public Employees Retirement Association	74.7%
	Mississippi	Mississippi Public Employees Retirement System	72.0%
	Nevada	Nevada Public Employees Retirement System	74.9%
	New Hampshire	New Hampshire Retirement System	68.0%
	New Mexico	New Mexico Educational Retirement Board	70.4%
	Ohio	Ohio State Teachers Retirement System	75.0%
	Oklahoma	Oklahoma Public Employees Retirement System	74.1%
	Oklahoma	Oklahoma Teachers Retirement System	49.3%
	Rhode Island	Rhode Island Employees Retirement System	59.6%
	South Carolina	South Carolina Retirement Systems	71.6%
	West Virginia	West Virginia Public Employees Retirement System	73.2%
	West Virginia	West Virginia Teachers Retirement System	19.1%
	Totals/Average of 85 inc. Funds:		82.0%

Source: Wisconsin Legislative Council (2007).

Our Reform Proposals For Social Security



Our Methodology Provides the Broad Direction of a Successful SS Reform, Not a Detailed Plan:

Restoring Long-term Solvency;

- Targeted SS Benefit Reductions for High-Income Groups, Proportional to the Individual Benefits Received by this Group from Government Tax-Breaks towards Pension Savings
- Direct Life Expectancy Linkage of SS Retirement Eligibility Ages after 2027
- (Possible) Additional Increases in Trust Fund Revenues

Boosting Low-Income Groups' Savings Towards Retirement;

- Add-on Private Accounts Targeted towards these Groups